

DELEGATE LOUDERBACK'S RESTRUCTURING PROPOSAL

Attached are four exhibits that explain the tax restructuring proposal offered by Delegate Louderback. The proposal would make changes to Virginia's individual income tax and retail sales and use tax, which are the Commonwealth's two largest sources of general fund revenues.

Proposed changes to individual income tax

Exhibit A explains the proposed changes to Virginia's individual income tax. Under Delegate Louderback's proposal, all current subtractions, deductions, tax credits, and other offsets (e.g. age deduction, itemized and standard deductions, personal exemptions) against income subject to individual income taxes would be repealed, with the sole exception for the current subtraction for social security income. Thus, under this proposal, taxable income for individuals in Virginia would be their income reported on their federal income tax return (federal adjusted gross income) less any income from social security payments.

In replacement of virtually all currently available offsets against income, the proposal provides for a 0.00% tax on the first \$15,000 of income earned by individuals and the first \$30,000 of income earned by married persons.

A second aspect of the proposal is a change to the current individual income tax brackets. Taxable income above \$50,000 would be taxed at a rate of 6.25%; under current law such income would be taxed at a rate of 5.75%.

The Department of Taxation has estimated that there would be a \$469.1 million decrease in revenue in Fiscal Year 2005 and a \$459.4 million decrease in revenue in Fiscal Year 2006 under this proposal. Similar annual decreases in revenue would occur on an ongoing basis.

Enclosed in this packet are examples of a taxpayer's liability for individual income taxes under current law and under Delegate Louderback's proposal (See Exhibit B).

Proposed changes to retail sales and use tax

Exhibit C explains the proposed changes to Virginia's retail sales and use tax. Under Delegate Louderback's proposal essentially all current sales tax exemptions would be repealed (e.g. drugs, nonprofits, agricultural) and all services in Virginia would be subject to the general retail sales and use tax (e.g. haircuts, legal, construction-related). The only transactions that would be exempt from sales and use tax would be sales of industrial materials for manufacturing,

sales to governments and sales of aircraft, watercraft, motor vehicles, and fuel. The sales of aircraft, watercraft, motor vehicles, and fuel, while exempt from Virginia's general sales and use tax, are currently subject to other sales or sales-like taxes. For instance, motor vehicles are subject to a 3 percent motor vehicle sales and use tax, gasoline is subject to a 17.5 cents per gallon fuels tax and diesel fuel is subject to a 16 cents per gallon fuels tax, aircraft are subject to a 2 percent aircraft sales and use tax, and watercraft are subject to a 2 percent watercraft sales and use tax.

As discussed above, the current sales and use tax base would be broadened to include a sales tax on every service performed in Virginia, in part or in whole.

Like the proposed changes to Virginia's individual income tax, the proposal would also change the current sales tax rate. The proposal would reduce the current retail sales and use tax rate from 4.5% to 4.0%.

In summary, the general retail sales and use tax rate would be reduced from 4.5% to 4.0%, essentially all current sales and use tax exemptions would be repealed, and all services would be subject to the 4.0% sales and use tax (most services currently are not subject to sales and use taxes).

It is estimated that these changes to the sales and use tax would generate approximately an additional \$1.6 billion in annual revenue.

Reconciliation of income tax and sales and use tax restructuring proposals

Exhibit D reconciles the proposed changes to the individual income tax and the retail sales and use tax. In addition to making up the loss in annual revenue from restructuring of the individual income tax, Delegate Louderback proposes eliminating or repealing several other taxes from the additional revenue estimated to be generated from restructuring of the retail sales and use tax.